

ALTERNATIVE FORECASTS

DRI has assigned a 55% probability of occurrence to its November 1998 baseline forecast of the U.S. economy. The major features of this forecast include:

- real GDP growth is 3.6% this year, dips to 1.7% next year, then averages about 2.3% thereafter;
- U.S. nonfarm employment rises 2.5% in 1998 then grows between 1.2% and 1.3% through 2002;
- the U.S. civilian unemployment rate rises gradually from 4.5% this year to 5.4% in 2002;
- consumer confidence peaks in 1998, then tapers off over the forecast period;
- consumer inflation accelerates from 1998's 1.6%, but remains under 3.0% through 2002;
- the federal budget posts surpluses in each year of the forecast;
- and the U.S. merchandise trade deficit widens.

While the baseline scenario represents the most likely outcome for the national economy over the next few years, the uncertainties surrounding several key variables mean that other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their impacts on the Idaho economy, are discussed below.

While it is believed the economy will not suffer a recession over the forecast period, it should be noted that the risk of a recession is high. A review of the probabilities of occurrence for each forecast scenario shows this. The baseline does not include a recession and its probability of occurrence is 55%. However, both of the alternative scenarios do contain recessions and their combined probability of occurrence is 45%. This implies the chances of the economy suffering a recession are just about even with the economy escaping a recession.

PESSIMISTIC SCENARIO

This scenario has been assigned a 30% probability of occurrence. In this case, the Asian contagion spreads further and is more harmful than in the baseline case. An unexpected devaluation of the Chinese currency in early 1999 starts a domino effect that is eventually felt in the U.S. The mechanics of this chain of events is as follows: the Chinese monetary devaluation sets off another round of currency devaluations in Asia. As a result, regional stock markets turn down and recessions deepen in all major Asian countries, including China. Stiff competition from Asian producers, aided by their cheaper currencies, drags Latin America into recession. The Latin American currencies then collapse in response to the Asian devaluations. These international troubles cut U.S. exports, which results in the layoffs of American workers.

As a result of these layoffs, U.S. consumer confidence falls and this takes a toll on consumer spending. This, along with the ongoing slide in foreign demand, pushes the U.S. economy into recession in the first quarter of 1999. The sale of large-ticket items is especially hard hit during this downturn. For example, despite the lowest mortgage rates since the mid-1960s, the housing market falters. The economy is not left alone to recover from its wounds, however. It is assumed the Federal Reserve lowers interest rates quickly

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
JANUARY 1999

	BASELINE				PESSIMISTIC				LATE RECESSION			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
GDP (BILLIONS)												
Current \$	8,775	9,158	9,547	10,014	8,621	8,859	9,215	9,670	8,866	9,059	9,455	9,984
% Ch	3.4%	4.4%	4.2%	4.9%	1.6%	2.8%	4.0%	4.9%	4.4%	2.2%	4.4%	5.6%
1992 Chain-Weighted	7,661	7,837	7,999	8,200	7,527	7,631	7,832	8,090	7,717	7,668	7,819	8,066
% Ch	1.7%	2.3%	2.1%	2.5%	0.0%	1.4%	2.6%	3.3%	2.5%	-0.6%	2.0%	3.2%
PERSONAL INCOME - CURR \$												
Idaho (Millions)	27,074	28,460	29,943	31,624	26,889	28,042	29,366	30,877	27,240	28,650	30,068	31,863
% Ch	4.4%	5.1%	5.2%	5.6%	3.7%	4.3%	4.7%	5.1%	5.0%	5.2%	4.9%	6.0%
U.S. (Billions)	7,426	7,748	8,088	8,470	7,349	7,550	7,831	8,187	7,483	7,791	8,068	8,475
% Ch	4.3%	4.3%	4.4%	4.7%	3.2%	2.7%	3.7%	4.6%	5.1%	4.1%	3.6%	5.1%
PERSONAL INCOME - 1992 \$												
Idaho (Millions)	23,549	24,175	24,808	25,539	23,467	24,070	24,709	25,496	23,587	24,002	24,525	25,325
% Ch	2.4%	2.7%	2.6%	2.9%	2.1%	2.6%	2.7%	3.2%	2.6%	1.8%	2.2%	3.3%
U.S. (Billions)	6,459	6,582	6,702	6,841	6,410	6,474	6,582	6,754	6,480	6,527	6,581	6,737
% Ch	2.3%	1.9%	1.8%	2.1%	1.5%	1.0%	1.7%	2.6%	2.6%	0.7%	0.8%	2.4%
TOTAL NONFARM EMPLOYMENT												
Idaho (Thousands)	532.2	543.7	555.4	569.0	529.7	538.7	551.8	566.7	533.2	540.7	548.7	566.0
% Ch	1.6%	2.2%	2.1%	2.5%	1.2%	1.7%	2.4%	2.7%	1.8%	1.4%	1.5%	3.2%
U.S. (Millions)	127.4	128.9	130.5	132.2	126.3	126.3	127.9	130.3	127.9	127.9	127.9	130.2
% Ch	1.3%	1.2%	1.2%	1.3%	0.4%	0.0%	1.3%	1.9%	1.7%	0.0%	0.0%	1.8%
GOODS PRODUCING SECTOR												
Idaho (Thousands)	109.1	110.4	111.4	112.5	107.3	107.2	109.4	111.0	109.8	108.3	109.1	112.8
% Ch	-1.5%	1.2%	0.9%	0.9%	-3.2%	-0.1%	2.0%	1.5%	-0.9%	-1.4%	0.8%	3.4%
U.S. (Millions)	24.5	24.1	23.9	23.9	24.1	23.0	22.9	23.3	24.7	23.8	23.1	23.4
% Ch	-2.9%	-1.7%	-0.8%	0.0%	-4.5%	-4.4%	-0.5%	1.5%	-2.1%	-3.7%	-2.7%	1.4%
SERVICE PRODUCING SECTOR												
Idaho (Thousands)	423.1	433.3	443.9	456.6	422.4	431.5	442.4	455.7	423.4	432.4	439.6	453.2
% Ch	2.5%	2.4%	2.5%	2.8%	2.3%	2.1%	2.5%	3.0%	2.6%	2.1%	1.6%	3.1%
U.S. (Millions)	102.9	104.9	106.6	108.3	102.2	103.2	104.9	107.0	103.2	104.1	104.8	106.7
% Ch	2.3%	1.9%	1.7%	1.6%	1.6%	1.0%	1.7%	2.0%	2.6%	0.9%	0.7%	1.9%
FINANCIAL MARKETS												
Federal Funds Rate	4.4%	4.1%	4.5%	4.5%	3.9%	3.5%	3.9%	4.5%	4.9%	5.4%	4.4%	3.6%
Bank Prime Rate	7.4%	7.1%	7.5%	7.5%	6.9%	6.5%	6.8%	7.5%	7.7%	8.4%	7.4%	6.6%
Mort Rate, New Homes	6.7%	6.3%	6.5%	6.6%	6.6%	6.3%	6.5%	6.9%	6.8%	7.4%	7.1%	6.6%
INFLATION												
GDP Price Deflator	1.6%	2.0%	2.1%	2.3%	1.5%	1.3%	1.4%	1.6%	1.9%	2.8%	2.4%	2.4%
Personal Cons Deflator	2.0%	2.4%	2.5%	2.6%	1.6%	1.7%	2.0%	1.9%	2.4%	3.4%	2.7%	2.6%
Consumer Price Index	2.4%	2.7%	2.8%	2.8%	2.1%	1.9%	2.1%	2.1%	2.9%	3.7%	2.8%	2.7%

Forecast Begins the **THIRD** Quarter of 1998

and aggressively. The recession is relatively mild thanks to the fundamental strength of the U.S. economy, the lack of domestic inflation, and the timely Federal Reserve action. By 2000, the economy is on the mend. Unfortunately, it takes the federal budget longer to recover. The recession cuts tax revenues, sending the federal budget into red ink in fiscal years 2000, 2001, and 2002.

In this scenario Idaho employment growth is weaker in the first two years compared to the baseline forecast. However, it does pick up speed in the latter half of the forecast period as the national economy rebounds from its downturn. Despite its late surge, Idaho nonfarm employment never fully closes the gap between this scenario and the baseline. In 2002, Idaho nonfarm employment is about 2,000 lower than in the baseline case. Like employment, Idaho personal income also grows slower in the first half of the forecast. In 2002, Idaho nominal personal income is \$750 million lower than in the baseline and Idaho real personal income is down about \$40 million.

LATE-RECESSION SCENARIO

The *Late-Recession Scenario* has been assigned a 15% probability of occurrence. In this scenario, the U.S. economy is strong, but not booming, through 1999. With confidence relatively high and wages rising, consumers continue to spend. The strong domestic demand offsets the slowdown in exports to Asia, helping the unemployment rate remain low. Desiring to ward off any near-term U.S. recession while not doing anything to further damage those foreign economies in crises, the Federal Reserve cuts the federal funds rate to 4.5% in the spring of 1999. Eventually, this strong growth leads to higher inflation. Oil prices increase as producers successfully cut back production. Further, the strong consumption prompts greater investment in both equipment and structures, creating bottlenecks in the capital goods industry and putting additional upward pressure on prices. By late-spring 1999, it is clear that higher wage and fringe benefit increases are flowing through to consumer prices.

The Federal Reserve attempts to stem inflation by raising the federal funds rate beginning in the summer of 1999. As inflation accelerates, consumer confidence plunges and bond yields rise, which causes the stock market to drop. The decline in consumer confidence drags down consumer spending and new home construction. With consumers retrenching, investments in both inventories and new facilities collapse. The economy slides into a three-quarter recession in 2000, producing a 2.0% peak-to-trough decline in real GDP. By the end of the recession, the stock market has retreated about 20% from its mid-1999 peak.

Idaho nonfarm employment is initially stronger in this scenario, but this advantage proves to be small and fleeting. In 1999, Idaho nonfarm employment is about 1,000 higher compared to the baseline. However, the slowing U.S. economy takes its toll on Idaho employment in the remaining years, and by 2002 Idaho nonfarm employment is actually 3,000 lower than in the baseline case. Interestingly, Idaho nominal personal income is higher in each year than in the baseline forecast. However, most of this gain is driven by higher inflation. After adjusting for inflation, Idaho personal income in this scenario is actually lower in the last three years of the forecast compared to the baseline case.